

Indiana Department of State Revenue
Revenue Ruling #2003-01FIT
January 8, 2003

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ISSUE

Treatment of Conditional Sales/Finance Lease income for purposes of calculating the 80% test to determine if a corporation qualifies as a "Taxpayer" under the Financial Institutions Tax [IC 6-5.5].

Authority: IC 6-5.5; IC 6-5.5-1-17(d) (2); 45 IAC 17-2-4(e) (2).

The Taxpayer, a corporation which is a financial organization primarily engaged in Making loans through a variety financing arrangements worldwide.

STATEMENT OF FACTS

Taxpayer is a Delaware corporation headquartered outside of Indiana. Taxpayer is a Wholly-owned Subsidiary of "XYZ" [the Parent] also a Delaware corporation headquartered outside of Indiana. The parent and certain other subsidiaries are engaged in the manufacture and sale of heavy equipment, including construction and agriculture machinery, engines and related equipment. Taxpayer is a financial organization primarily engaged in making loans through a variety of financing arrangements. Taxpayer and its subsidiaries offer these financing arrangements to the independent dealers of Parent and its affiliates and the dealers' customers in acquiring Parent Equipment worldwide. Generally, these financing arrangements are initiated either by Taxpayer or, alternatively, by the dealer and subsequently acquired by Taxpayer.

Taxpayer may enter into a financing agreement directly with the customer after the dealer and customer have agreed on the purchase price and method of delivery of the Equipment. Under this scenario, Taxpayer may purchase the Equipment from the dealer and will have the dealer deliver Equipment to the customer. Under the terms of the financing agreement, Taxpayer pays the purchase price to the dealer, and the customer agrees to repay Taxpayer pursuant to the terms of the financing arrangement.

Alternatively, the dealer may issue the loan documents and assign the documents to Taxpayer. The dealer negotiates the terms of the financing arrangement, enters into a financing agreement with the customer, executes the agreement and completes both the sale and the financing. If the terms of the arrangement meet Taxpayer's requirements, Taxpayer may purchase the financing agreement.

Taxpayer engages in four primary retail financing arrangements which are:

- (1) Sales by Dealer
- (2) Conditional Sales/Finance Leases
- (3) Installment Sales
- (4) Long Term Operating Leases

Taxpayer's conditional sales/finance leases are treated as loans, not leases, for federal income tax purposes. Federal law requires Taxpayer to divide each rental payment into interest and principal. The interest component is reported as interest income on its Federal Form 1120 in the year the payment is received. Taxpayer reports 100% of the principal amount to be paid over the life of the lease on line (1a) of its Federal Form 1120 in the year the lease is executed. Taxpayer is in the business of financing the sale of Equipment, not selling such equipment at a profit. Accordingly, the principal payments under the finance lease equal the amount Taxpayer paid for the equipment and Taxpayer does not report any gross profit on finance leases.

The issue is how conditional sales/finance leases are treated for purposes of calculating the 80% test provided in IC 6-5.5-1-17(d) (2).

RULING

The Department rules that for purposes of determining Taxpayers requirement to report and pay tax under the Indiana Financial Institutions Tax [IC 6-5.5] it must derive at least 80% of its gross income from doing the "business of a financial institution". In the matter of conditional sales/financing leases IC 6-5.5-1-17(d) (2) (B) provides that

"Leasing or acting as an agent, broker, or advisor in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes".

45 IAC 17-2-4(e) (2) provides:

"Leasing or acting as an agent, broker, or advisor, in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes. If the lease is the economic equivalent of the extension of credit, and the lease is not treated as a lease for federal income tax purposes, the income derived from the lease is included in gross income for purposes of satisfying the eighty percent (80%) test whether the corporation is leasing its own real or personal property or is the lessor of real or personal property owned by another."

Thus the Taxpayer is required to include the gross income derived from conditional sales/financing leases in calculating the 80% test to determine the requirement to file and pay tax under the Indiana Financial Institutions Tax.

CAVEAT

This ruling is issued to the Taxpayer requesting it on the assumption that the Taxpayer's facts and circumstances, as stated herein are correct. If the facts and circumstances given are not

correct, or if they change, then the Taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection

INDIANA DEPARTMENT OF REVENUE